

Internal Revenue Service

Department of the Treasury

Number: **200048030**

Washington, DC 20224

Release Date: 12/1/2000

Index Number: 355.00-00, 355.01-00,
355.04-00, 355.05-00, 332.00-00, 368.00-00,
368.05-00

Person to Contact:

Telephone Number:

Refer Reply To:

CC:CORP:1-PLR-101241-00

Date:

August 30, 2000

LEGEND:

Distributing =

Controlled =

Sub 1 =

Sub 2 =

Sub 3 =

LLC =

Controlled Sub 4 =

Controlled Sub 5 =

Controlled Sub 6 =

Trust =

m =

n =

p =

q =

r =

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s =

t =

Date =

State A =

Business W =

Business X =

Business Y =

Business Z =

Bank =

We respond to a letter dated January 10, 2000, in which your authorized representative requested rulings on behalf of Distributing regarding the federal income tax consequences of certain transactions. Your authorized representative submitted additional information in letters dated April 4, May 24, June 26, July 5, July 11, July 21 and August 3, 2000. The relevant information is summarized below.

Distributing is a State A corporation that engages in Business W, Business X, and Business Y. Distributing uses the accrual method of accounting and files consolidated federal income tax returns on a calendar year basis. Trust, a testamentary trust that is entitled to a charitable set-aside deduction under section 642(c)(2)(A), owns m percent of the outstanding stock of Distributing. Distributing wholly owns Sub 1 and several other subsidiaries that are not relevant to this ruling. Until Date, Distributing owned all the stock of Sub 2, which merged into Sub 3 on Date. Immediately thereafter, Sub 3 merged into a limited liability company, LLC. Distributing wholly owns LLC, and LLC is disregarded as a separate entity pursuant to section 301.7701-3 of the Income Tax Regulations.

Sub 1 owns n percent, which is less than 80 percent, of the outstanding Controlled stock. Controlled is included in Distributing's consolidated financial statements. Controlled is a State A corporation that engages, through its wholly-owned subsidiaries, in three lines of business. Controlled Sub 4 engages in Business X. Controlled Sub 5 engages in Business Y. Controlled

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Sub 6 engages in Business Z. Controlled uses the accrual method of accounting. Controlled is the common parent of an affiliated group of corporations, and files consolidated federal income tax returns on a calendar year basis.

The taxpayer has submitted financial information indicating that Distributing and Controlled each have had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

Controlled wishes to significantly expand Business Z. Controlled has immediate capital needs of approximately \$p for Business Z. Controlled wishes to borrow to meet those capital needs, but Distributing has prevented significant borrowing by Controlled because of potential interference with Distributing's own borrowing capacity. To further certain business goals, Distributing wishes to significantly increase its borrowing capacity. Independent investment advisors have advised Distributing in detailed and reasoned letters that Distributing cannot significantly increase its borrowing capacity and retain its investment grade credit rating if Controlled completes its desired borrowing and does not separate from Distributing. Furthermore, the investment advisors have indicated that if Controlled completes its desired borrowing without separating from Distributing, Distributing will be unable to renew its existing \$q line of credit with Bank on the same terms. Distributing's investment advisors have determined that the separation of Distributing and Controlled will enable Distributing to borrow more money on better terms than it could if the two corporations did not separate. Distributing has provided information showing that it can significantly reduce its borrowing costs if Distributing does not own Controlled stock. The projected cost savings exceed one percent of the base period net income of Distributing's affiliated group. To enable increased borrowing by Distributing, and to reduce Distributing's cost of borrowing, the taxpayer has taken or proposes to take the following steps:

- Step 1 Sub 2 merged into Sub 3. Sub 3 liquidated by merging into LLC, which is wholly-owned by Distributing ("Sub 3 Liquidation").
- Step 2 Sub 1 will liquidate by merging with and into Distributing ("Sub 1 Liquidation").
- Step 3 Controlled will cause Controlled Sub 4 to be converted into a limited liability company that will be wholly owned by Controlled and disregarded as an entity separate from Controlled under § 301.7701-3 of the Income Tax Regulations.

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Step 4 Controlled will amend its Articles of Incorporation to authorize the issuance of r shares of Class A common stock and s shares of Class B common stock. Both classes of stock will be listed on the New York Stock Exchange and will have identical rights to dividends and liquidation proceeds. Holders of the Class A stock will be entitled to vote for 20 percent of the Controlled directors, and holders of the Class B stock will be entitled to vote for the other 80 percent of the Controlled directors. The Class B voting stock rights will be subject to a limitation that a holder of more than t percent of the Class B stock may only vote that amount of Class B stock that is proportionate to the holder's economic interest in Controlled. Any excess shares of Class B stock automatically will be voted in the same proportion as the Class B shares held by Class B shareholders who hold less than t percent of the Class B shares. After amendment of the Articles, Distributing will exchange the Controlled common stock it will receive in Step 2 for Class B stock, and the Controlled stock held by all other Controlled shareholders will be exchanged for Class A stock ("Recapitalization").

Step 5 Distributing will distribute to its shareholders on a pro rata basis all of the Controlled Class B stock.

The taxpayer has made the following representations with respect to the spin-off transaction described in Step 5 above:

- (a) No part of the consideration to be distributed by Distributing will be received by a shareholder as a creditor, employee, or in any capacity other than that of a Distributing shareholder.
- (b) The five years of financial information submitted on behalf of the active businesses of Distributing and Controlled is generally representative of each business's present operations. With regard to each corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- (c) Following the spin-off transaction, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees.
- (d) The distribution of the stock of Controlled will be carried out for the following corporate business purposes: to produce significant cost savings for Distributing and to facilitate borrowing by Distributing.

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- (e) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of the Controlled stock, other than indebtedness incurred in the ordinary course of business. The indebtedness owed by Controlled to Distributing after the spin-off will not constitute stock or securities.
- (f) Except as noted in Steps 1, 2, and 4 above, there is no plan or intention to liquidate either Distributing or Controlled, to merge either corporation with any other corporation, or to sell or otherwise dispose of the assets of either corporation after the spin-off transaction, except in the ordinary course of business.
- (g) There is no plan or intention on the part of any shareholder who owns 5 percent or more of the stock of Distributing and, to its best knowledge, the management of Distributing is not aware of any plan or intention on the part of any remaining shareholder of Distributing, to sell, exchange, transfer by gift, or otherwise dispose of any stock in either Distributing or Controlled after the spin-off transaction, except that Trust may elect to participate in a Distributing stock repurchase program.
- (h) There is no plan or intention by either Distributing or Controlled, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the spin-off, other than through stock purchases meeting the requirements of section 4.05(1)(b) of Rev. Proc. 96-30, provided, however, that if the Trust elects to participate in a future Distributing share repurchase program, Distributing may repurchase shares of stock directly from the Trust.
- (i) Payments made in connection with all continuing transactions between Distributing and Controlled will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (j) No two parties to the spin-off transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).
- (k) The spin-off transaction is not part of a plan or series of related transactions (within the meaning of section 355(e)) pursuant to which one or more persons will acquire directly or indirectly stock possessing 50 percent or more of the total combined voting power of all classes of stock of Distributing or Controlled, or stock possessing 50 percent or more of the total value of all classes of stock of Distributing or Controlled. For purposes of this representation, in

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measuring whether the 50 percent limitation has been violated, the change in voting rights effected by the recapitalization in Step 4 will be treated as an acquisition by Distributing and/or its shareholders of voting stock in Controlled.

The taxpayer has made the following representations with respect to the liquidation transaction described in Step 1 above:

- (l) The merger of Sub 2 into Sub 3 qualified as a reorganization under section 368(a)(1)(F) of the Code.
- (m) Distributing, on the date of adoption of the plan of liquidation and at all times until the final liquidating distribution was completed, was the owner of at least 80 percent of the single outstanding class of the Sub 3 stock.
- (n) No shares of Sub 2 or Sub 3 common stock were redeemed during the three years preceding the adoption of the plan of liquidation.
- (o) All distributions from Sub 3 to Distributing pursuant to the plan of complete liquidation were made within a single taxable year.
- (p) As soon as the first liquidating distribution was made, Sub 3 ceased to be a going concern and its activities were limited to winding up its affairs, paying its debts, and distributing its assets to its shareholders.
- (q) All the stock in Sub 3 has been canceled and Sub 3 has been dissolved.
- (r) Sub 3 retained no assets following the final liquidating distribution.
- (s) Other than as a result of the merger of Sub 2 into Sub 3, which qualified as a reorganization under section 368(a)(1)(F), neither Sub 2 nor Sub 3 acquired any assets in any nontaxable transaction at any time, except for acquisitions occurring more than 3 years prior to the date of adoption of the plan of liquidation.
- (t) No assets of Sub 2 or Sub 3 were disposed of by either Sub 2, Sub 3 or Distributing except for dispositions in the ordinary course of business and dispositions occurring more than 3 years prior to the date of adoption of the plan of liquidation.
- (u) The liquidation of Sub 3 was not preceded by nor will be followed by the reincorporation in, or transfer or sale to, a recipient corporation of

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any of the businesses or assets of Sub 3, if persons holding, directly or indirectly (as determined under section 318(a) as modified by section 304(c)(3)), more than 20 percent in value of the Sub 3 stock also hold, directly or indirectly, more than 20 percent in value of the stock of the recipient corporation.

- (v) Prior to the adoption of the plan of liquidation, no assets of Sub 3 were distributed in kind, transferred or sold to Distributing, except for (i) transactions occurring in the normal course of business; and (ii) transactions occurring more than 3 years prior to the date of adoption of the liquidation Plan.
- (w) Sub 3 will report all earned income represented by assets that will be deemed distributed to Distributing, such as receivables being reported on a cash basis, unfinished contracts, commissions due, etc.
- (x) The fair market value of the assets of Sub 3 exceeded its liabilities both at the date of adoption of the plan of liquidation and immediately prior to the time the first liquidating distribution occurred.
- (y) There was no intercorporate debt existing between Sub 2 or Sub 3 and Distributing and none was canceled, forgiven or discounted, except for transactions that occurred more than 3 years prior to the date of adoption of the plan of liquidation.
- (z) Distributing is not an organization that is exempt from federal income tax under section 501 or any other provision of the Code.

Based solely on the information submitted and the representations set forth above, we hold as follows for federal income tax purposes:

Step1

- (1) The Sub 3 Liquidation will be treated as a distribution by Sub 3 of all of its assets to Distributing in complete liquidation under section 332 of the Code.
- (2) No gain or loss will be recognized by Distributing on its receipt of Sub 3 assets in the Sub 3 Liquidation. Section 332(a).
- (3) No gain or loss will be recognized by Sub 3 on the distribution of its assets to, or the assumption of its liabilities by, Distributing in the Sub 3 Liquidation. Sections 336(d)(3), 337(a), and 337(b).
- (4) Distributing's basis in each Sub 3 asset distributed to Distributing in

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the Sub 3 Liquidation will equal Sub 3's basis in such Sub 3 asset immediately before the Sub 3 Liquidation. Section 334(b)(1).

- (5) The holding period of each Sub 3 asset received by Distributing in the Sub 3 Liquidation will include Sub 3's holding period for each Sub 3 asset. Section 1223(2).
- (6) Distributing will succeed to and take into account the items of Sub 3 described in section 381(c), subject to the limitations of sections 381(b) and (c) and the regulations thereunder. Sections 381(a) and 1.381(a)-1.

Step 2

- (7) The Sub 1 Liquidation will be treated as a liquidation by Sub 1 of all of its assets to Distributing in complete liquidation under section 332.
- (8) No gain or loss will be recognized by Distributing on its receipt of Sub 1 assets in the Sub 1 Liquidation. Section 332(a).
- (9) No gain or loss will be recognized by Sub 1 on the distribution of its assets to, or the assumption of its liabilities by, Distributing in the Sub 1 Liquidation. Sections 336(d)(3), 337(a), and 337(b).
- (10) Distributing's basis in each Sub 1 asset distributed to Distributing in the Sub 1 Liquidation will equal Sub 1's basis in such Sub 1 asset immediately before the Sub 1 Liquidation. Section 334(b)(1).
- (11) The holding period of each Sub 1 asset received by Distributing in the Sub 1 Liquidation will include Sub 1's holding period for each Sub 1 asset. Section 1223(2).
- (12) Distributing will succeed to and take into account the items of Sub 1 described in section 381(c), subject to the limitations of sections 381(b) and (c) and the regulations thereunder. Sections 381(a) and 1.381(a)-1.

Step 4

- (13) The Recapitalization will be treated as an exchange by Distributing of its Controlled common stock for Controlled Class B common stock and will qualify as a reorganization under section 368(a)(1)(E). Controlled will be a "party to a reorganization" within the meaning of section 368(b).
- (14) No gain or loss will be recognized by Distributing on the Recapitalization. Section 354(a).

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- (15) The basis of the Controlled Class B common stock received in the Recapitalization will equal the basis of the Controlled common stock surrendered in exchange therefor. Section 358(a)(1).
- (16) The holding period of the Controlled Class B common stock received in the Recapitalization will include the period during which the shares of Controlled common stock surrendered in exchange therefor were held, provided that the surrendered shares of Controlled common stock were held as a capital asset on the date of the exchange. Section 1223(1).

Step 5

- (17) No gain or loss will be recognized by the Distributing shareholders on their receipt of Controlled Class B common stock. Section 355(a).
- (18) No gain or loss will be recognized by Distributing on the distribution of Controlled Class B common stock to Distributing shareholders. Sections 355(c)(1) and 311(a).
- (19) The aggregate basis in Distributing common stock and Controlled common stock held by each Distributing shareholder will equal the aggregate basis of such shareholder's Distributing common stock immediately before the distribution, allocated in proportion to the relative fair market values of Distributing common stock and Controlled Class B common stock at the time of the distribution. Sections 355(b) and (c) and § 1.358-2(a)(2).
- (20) The holding period of the Controlled Class B common stock received by each Distributing shareholder will include the holding period for the shareholder's Distributing common stock, provided that the Distributing common stock is held as a capital asset on the day of the spin-off. Section 1223(1).
- (21) If cash is received by a Distributing shareholder in lieu of a fractional share of Controlled Class B common stock, gain or loss will be recognized by the shareholder measured by the difference between the basis of the fractional share received, as determined in (19) above, and the amount of cash received. Section 1001. If the fractional share qualifies as a capital asset in the hands of the shareholder, the gain or loss will be a capital gain or loss subject to the provisions of Subchapter P of Chapter 1 of the Code. Sections 1221 and 1222.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of

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perjury statement executed by an appropriate party. This office has not verified any of the material submitted in support of the request for a ruling. Verification of the factual information, representations, and other data may be required as part of the examination process. Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling letter is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. A copy of this letter must be attached to any income tax return to which it is relevant.

Pursuant to the power of attorney on file in this office, a copy of this letter has been sent to your authorized representative.

Sincerely,
Associate Chief Counsel (Corporate)
By: Mark Jennings
Acting Chief, Branch 1